

Message Text

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ACTION EA-12

INFO OCT-01 ISO-00 SOE-02 AID-05 CEA-01 CIAE-00
COME-00 DODE-00 EB-08 DOE-11 H-01 INR-07 INT-05
L-03 NSAE-00 NSC-05 OMB-01 PM-05 USIA-06 OES-07
SP-02 SS-15 STR-06 TRSE-00 ACDA-12 PA-01 PRS-01
/117 W

-----050224 271032Z /20

R 270440Z JAN 78
FM AMEMBASSY JAKARTA
TO SECSTATE WASHDC 6416
INFO AMCONSUL MEDAN
AMCONSUL SURABAYA
AMEMBASSY TOKYO

C O N F I D E N T I A L SECTION 1 OF 2 JAKARTA 1189

E.O. 11652: GDS
TAGS: ENRG, ID
SUBJECT: PAC/INDO LNG CONTRACTS -- STILL ALIVE

1. SUMMARY: INDONESIA'S DESIRE TO SELL LNG TO US REMAINS STRONG, BUT GOI IS DISCOURAGED BY US OBJECTIONS TO CURRENT PRICE ESCALATOR INDEX. INITIAL GOI REACTION TO DOE PAC/INDO RULING WAS MIXED BUT AS FIRST TENDED TO FAVOR CANCELLATION OF CONTRACTS. HOWEVER, AS RESULT OF RECENT DISCUSSIONS BETWEEN PERTAMINA AND CALIFORNIA UTILITY OFFICIALS. PAC/INDO NOW INTENDS REQUEST RE-HEARING ON DOE DECISION IN ORDER PROVIDE TIME FOR PERTAMINA AND PAC/INDO DISCUSS FUTURE OF CONTRACTS. FURTHER INDONESIAN NEGOTIATIONS ON CONTRACTS WILL BE CONSTRAINED BY A) DESIRE NOT TO JEOPARDIZE LNG PRICING ARRANGEMENTS ALREADY MADE WITH JAPAN; B) EXTREME SENSITIVITY TO NEW FEDERAL OR STATE DELAYS IN APPROVAL PROCESS; C) IMPORTANT PROCEDURAL POINT THAT GOI WILL NOT PERMIT ITSELF BE PUT IN POSITION OF "SUPPLICANT" TO DOE. DESPITE CURRENT DECISION TO PROCEED, WHICH REQUIRED APPROVAL BY PRESIDENT SUHARTO, EMBASSY BELIEVES CHANCES FOR SUCCESSFUL CONCLUSION OF CONTRACTS ARE UNCERTAIN. WE SEE AT LEAST TWO AREAS
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WHERE EMBASSY AND/OR DEPARTMENT ACTION MAY MAKE CONSTRUCTIVE CONTRIBUTION TO FURTHER NEGOTIATIONS. THESE ARE SPELLED OUT IN PARA 8.
END SUMMARY.

2. INITIAL GOI REACTION TO PAC/INDO RULING: FOLLOWING DECEMBER 30 DOE DECISION ON PAC/INDO CONTRACTS, GOI ECONOMIC LEADERS WERE

DIVIDED AS TO BEST POLICY RESPONSE. MOST, INCLUDING SADLI AND WIJARSO, PREFERRED TO STICK TO JANUARY 31 DEADLINE PREVIOUSLY GIVEN TO CALIFORNIA UTILITIES AS DATE BY WHICH CONTRACTS, INCLUDING PRICE ESCALATOR, MUST BE ENTIRELY FINALIZED OR CANCELLED. BY STICKING TO DEADLINE, THESE OFFICIALS REALIZED CONTRACTS WOULD BE CANCELLED AT END OF JANUARY, BUT THEY BELIEVED SUBSTANTIVE ISSUES STILL OUTSTANDING AT FEDER AND STATE LEVELS MADE EVENTUAL CANCELLATION PROBABLE ANYHOW. BEYOND THIS THEY FELT BOTH FOR POLITICAL AND PSYCHOLOGICAL REASONS THE GOI SHOULD NOT BE IN A POSITION OF SUPPLICANT TO DOE ON LNG MATTERS, AND FOR DOMESTIC AND INTERNATIONAL POLITICAL REASONS IT WAS BETTER FOR GOI TO CANCEL THE CONTRACTS RATHER THAN RISK US FEDERAL OR STATE OFFICIALS DICTATING UNACCEPTABLE TERMS THAT WOULD CAUSE CANCELLATION. PERTAMINA, AND IN PARTICULAR GENERAL HARYONO,

REACTED SOMEWHAT DIFFERENTLY TO PAC/INDO RULING AND PREFERRED TO WORK WITH US UTILITIES TO MEET DOE OBJECTIONS TO PRICE INDEX.

3. INTRA-GOI DEBATE ON RESPONSE TO PAC/INDO RULING
APPARENTLY CRYSTALLIZED EVENING OF JANUARY 12 WHEN A MEETING OF PERTAMINA BOARD OF COMMISSIONERS, WHICH INCLUDES WIDJOJO, REPORTEDLY HEARD EMOTIONAL STATEMENT FROM SADLI, WHO CLAIMED THE PURPOSE OF DOE RULING IS TO SPLIT INDONESIA FROM ITS OPEC PARTNERS AND THAT IRS AND DOE ACTIONS
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ARE PART OF USG STRATEGY TO ACCOMPLISH THIS. THE MEETING TOUCHED ON SUBSTANCE OF DOE OBJECTIONS TO ESCALATOR INDEX AND CURRENCY ADJUSTMENT, BUT WE UNDERSTAND THE TONE OF DISCUSSION WAS SET BY SADLI'S REMARKS. IN TYPICAL JAVANESE FASHION, NO SPECIFIC DECISION WAS TAKEN AT MEETING, BUT MOST PARTICIPANTS LEFT WITH IMPRESSION THAT CONSENSUS HAD BEEN REACHED TO CANCEL CONTRACTS AT END OF JANUARY.

4. BASIC GOI CONCERNS: AT LEAST FOUR BASIC CONCERNS UNDERLIE GOI PERCEPTIONS OF HOW TO PROCEED ON PAC/INDO:
A) INDONESIAN/JAPANESE LNG CONTRACTS (OR SIDE LETTERS TO CONTRACTS) REPORTEDLY CONTAIN A KIND OF "MOST FAVORED NATION" PRINCIPLE ON PRICING SO THAT ANY SIGNIFICANT CONCESSIONS TO US ON LNG PRICING WOULD IN SOME MANNER APPLY TO EXISTING AS WELL AS TO FUTURE JAPAN/INDONESIA LNG ARRANGEMENTS; B) GOI IS CONCERNED THAT USG DOES NOT HAVE "ITS ACT TOGETHER" AND OBJECTIONS TO PRICE INDEX ARE SIMPLY THE LATEST AND BY NO MEANS THE LAST OF SEEMINGLY INTERMINABLE DELAYS; C) THE SEVERAL, AND INDIRECTLY UNFAVORABLE, REFERENCES TO OPEC PRICES IN THE DOE DECISION ON PAC/INDO UPSET SOME GOI OFFICIALS,

ESPECIALLY SADLI, WHO CLAIMED TO SEE USG FOREIGN POLICY
MOTIVES IN BACKGROUND OF DOE'S OBJECTIONS TO OPEC PRICES;
D) THE LEGACY OF THE IRS "NEGOTIATIONS" STILL CASTS A
SHADOW HERE AND GOI ENERGY OFFICIALS REGRET THAT CIRCUM-
STANCES REQUIRED THEM TO CHANGE TAX LAWS AS RESULT OF
IRS DECISION. THESE OFFICIALS BELIEVE INDONESIA'S
POSITION ON LNG IS STRONGER THAN ITS POSITION ON TAXES,
AND THEY ARE DETERMINED NOT TO BE EMBARRASSED IN FURTHER
DEALINGS WITH USG REGULATORY OR ADMINISTRATIVE AUTHORITIES.
ORIGINALLY GOI LNG REVENUE EXPECTATIONS WERE BASED ON
PROCEEDS FROM EXPORTS TO JAPAN FROM TWO LNG TRAINS IN
EAST KALIMANTAN AND THREE TRAINS IN ACEH, AS WELL AS EX-
PORTS TO THE US FROM THREE ADDITIONAL TRAINS IN ACEH.
HOWEVER, THE GOI IS NOW NEGOTIATING WITH JAPAN FOR EX-
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PANSION OF THE EAST KALIMANTAN PLANT TO FOUR TRAINS. IF
SUCCESSFUL BY 1981 GOI WILL HAVE IN PLACE SEVEN LNG
TRAINS EXPORTING TO JAPANESE MARKET. THUS, ORIGINAL
REVENUE PLANS CAN BE ABOUT MET WITHOUT US CONTRACTS.
THERE ARE OF COURSE STILL STRONG INCENTIVES, INCLUDING
MARKET DIVERSIFICATION AND ADDITIONAL REVENUE, TO SELL
ONG TO THE US, BUT NOT IF DOING SO JEOPARDIZES PRICE
ARRANGEMENTS WITH JAPANESE. WIJARSO IN PARTICULAR

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BELIEVES ARUN GAS CAN BE USED AS BASIS FOR REGIONAL DEVELOPMENT IN ACEH AND STILL BE AVAILABLE IN LESSER QUANTITY FOR EXPORT IN FUTURE.

5. VISIT OF CALIFORNIA LABOR GROUP AND UTILITY OFFICIALS: GIVEN THESE GOI CONCERNS AND RESULTS FO JANUARY 12 BOARD OF COMMISSIONERS MEETING, THE OUTLOOK FOR CONTINUED GOOD FAITH NEGOTIATION OF THE CONTRACTS WAS, AT BEST, UNCERTAIN ON THE EVE OF THE JANUARY 16-20 VISIT OF CALIFORNIA LABOR LEADERS AND UTILITY OFFICIALS. COMING ONLY TWO AND ONE-HALF WEEKS AFTER THE DOE DECISION, THE TIMING OF THE VISIT WAS FORTUITION, AND AFTER INSPECTING LNG RECEIVING AND REGASSIFICATION FACILITIES IN JAPAN AND TRAVELLING TO THE ARUN GAS FIELD AND LNG PLANT SITE IN INDONESIA, THE ALREADY STRONG SUPPORT OF CALIFORNIA LABOR FOR THE IMPORT OF INDONESIAN LNG INTO CALIFORNIA WAS APPARENTLY REINFORCED. DURING THE GROUP'S MEETING WITH HARYONO AND WIJARSO IN JAKARTA, THE LABOR LEADERS PROMISED TO USE LABOR'S POLITICAL INFLUENCE IN SACRAMENTO AND WASHINGTON TO EXPEDITE FINAL US APPROVAL OF THE CONTRACTS.
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6. PERTAMINA-PAC/INDO DISCUSSIONS: DURING THE WEEK JANUARY 16-23, PACIFIC LIGHTING AND PERTAMINA OFFICIALS MET DAILY TO DISCUSS THE DOE RULING AND THE FUTURE OF THE CONTRACTS. AS DISCUSSIONS PROGRESSED, PERTAMINA AND GOI OFFICIALS GRADUALLY MOVED TO A POSITION THAT WILL PERMIT CONTINUED NEGOTIATIONS DESIGNED TO EXPLORE POSSIBILITY OF MEETING DOE OBJECTIONS TO THE EXISTING PRICE ESCALATOR INDEXES. SEVERAL FACTORS PUSHED THE GOI IN THIS DIRECTION, INCLUDING A) UNDERLYING LOGIC OF TRYING TO CONCLUDE A BASICALLY PROFITABLE COMMERCIAL ARRANGEMENT WITH US; B) PERTAMINA'S INSTITUTIONAL DESIRE TO SEE THE CONTRACTS THROUGH TO A SUCCESSFUL CONCLUSION; C) ADVICE OF PERTAMINA'S WASHINGTON REPRESENTATIVE NOT TO LET CONTRACTS DIE AT THIS STAGE; D) INDICATIONS FROM PRELIMINARY RESEARCH THAT ALTERNATIVE PRICE INDECES MAY BE AVAILABLE THAT WILL MEET DOE REQUIREMENTS WITHOUT REDUCTING GOI REVENUE EXPECTATIONS; E) FAVORABLE IMPRESSION MADE BY CALIFORNIA LABOR GROUP, INCLUDING PROMISE TO TRY AND EXPEDITE US APPROVAL PROCESS; AND F) SOBER CALCULATION THAT INDONESIA'S CURRENT NEGOTIATING POSITION WITH JAPANESE ON DOUBLING OF PRODUCTION AND DELIVERIES OF LNG FROM EAST KALIMANTAN IS BEST SERVED BY KEEPING US OPTION "ALIVE." GOI INTENTIONS TO CONTINUE NEGOTIATIONS WERE OFFICIALLY SANCTIONED AT JANUARY 24 MEETING BETWEEN

HARYONO AND PRESIDENT SUHARTO.

7. CURRENT GOI POLICY: INDONESIAN HAVE ASKED PAC/INDO TO FILE A REQUEST FOR A REHEARING ON THE DOE RULING IN ORDER TO GAIN ABOUT THREE MONTHS TIME FOR PERTAMINA AND CALIFORNIA UTILITIES TO DISCUSS FUTURE OF CONTRACTS. EMBASSY HAS SEEN COPY OF PERTAMINA'S DRAFT LETTER OF SUPPORT FOR PAC/INDO'S REQUEST FOR REHEARING. PERTA-
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MINA'S LETTER, INTER ALIA, MAKES POINT THAT IT IS NOT JUST PERTAMINA, BUT SENIOR LEVELS OF THE INDONESIAN GOVERNMENT THAT ARE INVOLVED IN CONTINUING THESE NEGOTIATIONS AND SPECIFICALLY REMINDS THAT GOI RETAINS RIGHT TO CANCEL CONTRACTS AT ANY TIME. WE BELIEVE THE GOI'S WILLINGNESS TO CONTINUE GOOD FAITH NEGOTIATION IS CONSTRAINED BY THREE BASIC PARAMETERS: A) THE GOI WILL NOT WISH TO DISCUSS A PRICE INDEX THAT PUTS EXISTING OR FUTURE JAPANESE LNG PRICE ARRANGMENTS IN QUESTION B) THE GOI INTENDS AVOID BEING PUT IN POSITION WHERE DOE CAN SAY "NO" TO GOI APPROVED DECISION ON ANY ASPECT OF THE CONTRACTS. THIS ESSENTIALLY PROCEDURAL POINT MAY BE MORE DIFFICULT TO RESOLVE THAN THE SUBSTANCE OF AN ALTERNATIVE PRICE INDEX; C) THE GOI WILL BE EXTREMELY SENSITIVE TO ANY FURTHER FEDERAL OR STATE DELAYS IN THE APPROVAL PROCESS. THE GOI IS RELYING ON THE DOE STATEMENT THAT AGREEMENT ON PRICE INDEX WILL EXPITE RESOLUTION OF REMAING ISSUES AT FEDERAL LEVEL. INDONESIANS ESPECIALLY WANT FEDERAL/STATE COORDINATION ON SITING APPROVAL BE TIMED IN A WAY THAT DOES NOT DELAY FINANCING OR CONSTRUCTION OF THE PROJECT.

8. EMBASSY ASSESSMENT AND IMPLICATIONS FOR EMBASSY AND DEPARTMENT ACTION: VIEWED FROM JAKARTA, INDEONSIA DEFINITELY WANTS TO SELL LNG TO THE US BUT CHANCES FOR SUCCESSFUL CONCLUSION OF PAC/INDON CONTRACTS APPEAR UNCERTAIN. GOI APPROVED DECISION FOR PAC/INDO TO REQUEST REHEARING WILL BUY TIME, NOT ONLY FOR SUBSTANTIVE DISCUSSIONS, BUT ALSO FOR EMOTIONS TO CALM. EVEN ALLOWING FOR A REASONABLE DEGREE OF POSTURING IN GOI STATEMENTS, INDONESIAN PATIENCE WITH US DELAYS HAS PROBABLY NEARED BREAKING POINT, AND ANY ONE OF SEVERAL UNRESOLVED SUBSTANTIVE OR PROCEDURAL ISSUES COULD PROVIDE THE "STRAW." NONETHELESS, WE BELIEVE EMBASSY AND DEPARTMENT CAN HELP CREAT MORE REALISTIC NEGOTIATING CLIMATE AND PERHAPS SMOOTH PROCEDURAL PROBLEMS SO THAT SUBSTANTIVE DECISIONS
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ON PRICING, SITING, SAFETY, ETC. CAN BE REACHED ON THEIR MERITS WITHOUT COMPLICATIONS ARISING FROM POLITICAL SENSITIVITIES. FIRST, WE CAN DISPEL GOI SUSPICION THAT PAC/INDO DECISION IS PART OF USG ATTACH ON OPEC (A LA SADLI'S REPORTED REMARKS) OR THAT US HAS IN ANY WAY SINGLED OUT INDONESIA FOR UNFAVORABLE TREATMENT ON LNG MATTERS. THE EMBASSY ACTED QUICKLY IN LOW-KEY BUT DIRECT MANNER TO DO THIS WHEN ISSUE FIRST CAME UP, AND WE ARE CONTINUING TO DO SO. SECOND, EMBASSY BELIEVES THE PROCEDURAL ISSUE MENTIONED IN PARA 7B IS VERY IMPORTANT TO GOI. GOI PLANS TO ASK CALIFORNIA UTILITY OFFICIALS TO CONSULT WITH DOE TO GET A KIND OF "PRIOR" APPROVAL TO ANY NEW PRICE INDEX BEFORE GOI FORMALLY APPROVES THE INDEX AND BEFORE DOE IS ASKED FOR OFFICIAL RULING. FRANKLY, WE ARE NOT SURE IF THIS PLAN OF ACTION IS WORKABLE UNDER DOE PROCEDURES WHICH MAY BE GOVERNED BY EXPARTE CONTACT RULES. IF THERE IS A PROBLEM IN THIS RESPECT, IT IS ALREADY CLEAR THE GOI WILL ASK THE EMBASSY AND DEPARTMENT TO APPROACH DOE IN PLACE OF PAC/INDO OFFICIALS. WE WOULD APPRECIATE IT IF DEPARTMENT COULD INVESTIGATE PROCEDURAL RULES UNDER WHICH DOE IS OPERATING SO THAT WE CAN BE PREPARED TO GIVE ACCURATE READING OF POSSIBILITIES FOR EMBASSY OR DEPARTMENT ASSISTANCE. MASTERS

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 jan 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: LPG, CONTRACTS
Control Number: n/a
Copy: SINGLE
Draft Date: 27 jan 1978
Decaption Date: 01 jan 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 20 Mar 2014
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1978JAKART01189
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Expiration:
Film Number: D780040-0798
Format: TEL
From: JAKARTA
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1978/newtext/t19780115/aaaaamjm.tel
Line Count: 304
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: e6b270df-c288-dd11-92da-001cc4696bcc
Office: ACTION EA
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 6
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: n/a
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 29 apr 2005
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 3702852
Secure: OPEN
Status: NATIVE
Subject: PAC/INDO LNG CONTRACTS -- STILL ALIVE
TAGS: ENRG, ID
To: STATE
Type: TE
vdkgvwkey: odhc://SAS/SAS.dbo.SAS_Docs/e6b270df-c288-dd11-92da-001cc4696bcc
Review Markings:
Sheryl P. Walter
Declassified/Released
US Department of State
EO Systematic Review
20 Mar 2014
Markings: Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014